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TIGHTEST MONEY MARKET IN A GENERATION

BACK in March, this bulletin remarked on the striking similarity between swings in the money market and waves on a beach. The past few weeks have served to underscore the resemblance. From mid-July to mid-August, a brisk rally in fixed-income obligations succeeded in fooling some observers into the belief that the 12-month upswing in interest rates had run its course. Now, however, it is painfully evident that this is not the case. What lenders should prepare for, instead, is a fresh surge of money rates to new and unprecedented heights.

The abortive midsummer rally was sparked by several factors, including a seasonally light volume of new corporate and municipal issues; the improved cash position of the Treasury; the protracted steel strike; and a jittery stock market. All told, these forces, for a short time, proved strong enough to lower yields on Treasury issues by perhaps 10 to 15 basis points. However, they were destined to be short-lived. By the end of August their influence had disappeared and quotations for bills, notes, bonds, and mortgages again were in full retreat.

Perhaps a better word would be rout. In the two final weeks of August, to illustrate, the return on 91-day Treasury bills spurted from 3.41% to 3.89%, well above the previous postwar peak of 3.66% set during the worst of the 1957 credit stringency, and the highest rate for such securities since the bank holiday of March 1933. The new 4-3/4% notes, the enthusiastic reception of which in July helped stimulate the rally, dropped below par for the first time since their first appearance. Long-term Government bonds plummeted to all-time lows. In the field of new corporate issues, several syndicates offering utility bonds were dissolved abruptly, at heavy losses to the underwriters. Even a 5% coupon, which early this summer was snapped up eagerly by institutional investors, failed to spur demand. To cap the climax, commercial banks on September 1 raised their prime rate from 4½% to 5%.

In the mortgage market the effects also were plainly visible. On August 1, according to the Federal Housing Administration, secondary market prices for immediate delivery of FHA-insured 5-1/4% loans (with 25-year maturities and 10% or more downpayments) averaged 96.2, down from 96.5 on July 1, and 97 at the start of June. Average declines of 3/10 to 1/2 point were recorded in

the West, Southwest, Southeast, and Middle Atlantic areas, while a 1-point drop occurred in the Northeast.

To judge by scattered reports from various parts of the country, figures for September 1, due to be released in about 3 weeks, undoubtedly will show a further sag. Thus, according to one source, rates on conventional mortgages have climbed by $\frac{1}{2}\%$ to $7\frac{1}{2}\%$ in San Francisco. Top-grade conventionals are running to 6% and more in Chicago. One official in that city, the vice president in charge of lending for Talman Federal Savings and Loan Association, says flatly: "I've been with Talman for 20 years and money is tighter now than at any time I know of."

Perhaps the most significant guide of all to the mounting stringency in mortgage credit may be found in the secondary market operations of the Federal National Mortgage Association. On August 15, FNMA slashed purchase prices for FHAs and VAs acquired both over the counter and under standby commitments by $\frac{1}{2}$ point and 1 point, respectively. The agency also announced that it no longer would accept offerings on $4\frac{1}{2}\%$ FHA and VA loans, and it discontinued giving standby commitments on $4-3/4\%$ mortgages. Most revealing of all, Fannie Mae's weekly SMO report shows a sharp upswing in the number of liens offered to it for sale, as well as in the number acquired.

In the second quarter of 1959, offerings totaled nearly 17,000, compared with 10,700 in the first quarter. In recent weeks, moreover, they have been running at a quarterly rate of well over 25,000. By the same token, actual purchases in April-June totaled \$127 million, against \$97.7 million in January-March. Since mid-August the quarterly rate of purchases has spurted to nearly \$225 million. For FNMA itself, of course, the increase in activity is a favorable development -- indeed, not long ago the agency upped its monthly dividend from 20¢ a share to 23¢, the second hike this year. For the market as a whole, however, the trend is a clear-cut sign of mounting tightness.

Severe though it has been, the impact on mortgage discounts and loan rates has been cushioned by a little-noticed trend in home finance -- the steady rise in advances made by the Federal Home Loan Banks to member savings and loan institutions. Early this month, to illustrate, the banks made a public offering of \$181 million of 5% consolidated notes, due June 15, 1960. After completion of the financing, outstanding indebtedness of the Home Loan Bank system rose to \$1,402 million, an all-time high. Meanwhile, FHLB advances, which stood at \$939 million a year ago, currently have spurted to over \$1.3 billion. The increase in advances, of course, cannot continue indefinitely. Sooner or later the borrowings must be repaid. When the turnabout comes, it inevitably will add to the credit stringency.

Meanwhile, the reservoir of savings, which constitutes far and away the largest source of mortgage money, shows disturbing signs of shrinking. In the first quarter of 1959, according to the Federal Home Loan Bank Board, sav-

ings amassed in the familiar institutional and Government channels totaled \$3.4 billion, the same as in the fourth quarter of 1958, but well below the \$5.2 billion recorded in the first quarter of last year. Since spring, moreover, the downtrend, if anything, has picked up speed.

With one noteworthy exception -- the savings and loan associations, which continue to shatter all records -- thrift institutions this year seem to have gone out of fashion. In the first half of 1959, commercial banks added \$2.1 billion to their time deposits, compared with \$5.3 billion in the corresponding period of 1958. In the first 7 months of 1959, the Nation's mutual savings banks accumulated only \$531 million in net new deposits, compared with a gain of \$1.4 billion in the like months of 1958. In July alone, savings banks actually lost \$54 million in deposits, an untoward event which, over the past 10 years, has occurred only once before. That was in 1950, right after the outbreak of the war in Korea, when scare buying was at its height. As for savings bonds, their record is worst of all. In the first 7 months of 1959, redemptions have outstripped sales by more than \$2 billion; in July, the excess of redemptions over sales was running at the alarming annual rate of nearly \$5 billion.

The trend, moreover, is not apt to be reversed very soon. For one thing, officials in both State and Federal Governments, far from taking steps to encourage thrift these days, actually seem to be pursuing the opposite course. In Washington, as virtually everyone by now must be aware, Congress has refused either to raise the ceiling on long-term Government issues from the current 4-1/4%, or to improve the 3-1/4% return on U. S. savings bonds.

By the same token, State authorities have thrown roadblocks in the way of higher interest rates on thrift accounts. In New York, for example, the State Banking Board recently imposed a ceiling of 3½% on savings bank dividends. In California, where a group of savings and loan associations were bold enough to raise their dividend rates to 4½%, the Savings and Loan Commissioner promptly cracked down. The offending institutions, it now appears, will have to go back quietly to 4% at the end of the quarter.

Meanwhile, the urge to spend grows apace. In June, according to the Federal Reserve Board, consumer installment credit outstanding rose by nearly \$800 million, or at an annual rate of \$5.4 billion. Moreover, in coming months, the public's appetite will be whetted by the unveiling of the 1960 models, including the new compact cars of the Big Three. All told, buyers this fall will have 21 domestic makes from which to choose, instead of 16, to say nothing of the remodeled and restyled foreign cars.

Demand for funds from other sources also is running high. Despite the liquidation of inventories caused by the protracted walk-out in steel, as well as by the more recent shutdowns in such basic industries as copper, business loans have shown no sign of slackening. On the contrary, member banks in

107 cities, including New York, have reported recently steady week-to-week increases in commercial, industrial, and farm loans.

As for long-term capital, through the first 7 months of the current year, State and local governments sold \$5,082 million in tax-exempt securities, an all-time high. The visible supply of municipal bonds, while somewhat below that of a year ago at the end of August, is rising rapidly. To be sure, corporate bond flotations this year have dropped sharply from the 1958 level. In the first half of 1959, according to the SEC, corporations sold \$3.5 billion worth of debt securities, compared with \$5.4 billion in the like year-ago span. However, the likelihood is that such offerings will rise substantially in the months ahead.

For one thing, bank accommodation is growing harder and harder to come by. According to the latest word from the financial community, most prime borrowers these days must keep a minimum balance of 25% of their credit lines (just raised from 20%) in cash on deposit at the lending institution. Hence, the current prime rate of 5% actually is tantamount to an effective interest cost of well over 6%. As a result, borrowers in growing numbers are apt to turn to the capital market. Indeed, two big new corporate issues -- \$250 million of American Telephone and Telegraph Co. debentures and \$25 million of debentures of Sylvania Electric Products -- already are looming for sale this fall, and the total corporate calendar in sight stands at \$800 million, against \$290 million as recently as June. The sharp upturn in capital outlays, which now is under way, undoubtedly will lead a number of other corporations before long to the capital market.

Finally, the role of the monetary authorities must be appraised. Since last May, when the Federal Reserve raised the rediscount rate from 3% to 3½%, it has made no further moves to tighten credit. The deficit in commercial bank free reserves, which reached \$500 million late in the spring, has remained around that level ever since. However, as one money market observer put it the other day, with 3-month Treasury bills trading at yields in excess of the discount rate, "all of the technical conditions for a further hike in that rate would seem to be present." The timing, he went on to say, will depend upon the Fed's evaluation of such factors as the financing plans of the Treasury, probable reaction in Congress, and the continued impact of the steel strike. Sooner or later, in sum, a fresh increase in all short-term money rates is inevitable.

All the foregoing unmistakably adds up to just one thing: costlier and scarcer credit. In appraising prospects for the remainder of 1959, lenders would do well to count on the tightest money market in a generation.

